



Committee On Finance

Max Baucus, Ranking Member

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For Immediate Release
Wednesday, July 21, 2004

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Statement of U.S. Senator Max Baucus "Bridging the Tax Gap" Hearing

One of the strongest features of our democracy is our system of collecting income taxes through individual self-assessment.

President Franklin D. Roosevelt said:

"In 1776, the fight was for democracy in taxation. In 1936, that is still the fight. Taxes, after all, are the dues that we pay for the privileges of membership in an organized society. As society becomes more civilized, a Government is called on to assume more obligations to its citizens. The privileges of membership in a civilized society have vastly increased in modern times. But I am afraid we have many who still do not recognize their advantages and want to avoid paying their dues."

These words remain as true today as they were in 1936.

It is easy to bash the IRS. It is easy to bash the government. And that is why it is important for public officials to take the high road and remind taxpayers of why we pay taxes.

The dues we pay for the privileges of membership in a civilized society provide education for our kids. They provide police and fire protection. They ensure safe and efficient highways. They make our nation's parks available for generations to come. They take care of the elderly. And they help take care of our children.

This does not mean that taxpayers should pay more than they owe. As stated by the great jurist Learned Hand, "Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury." So, there is clearly a balance that we must strike. Unfortunately, we are not in balance.

Over the last 3 years, we have been on a destructive fiscal path. As a result, our federal budget has gone from the largest surplus in our nation's history to the largest deficit in our nation's history. This year's deficit will likely top \$400 billion.

But if that sea of red ink is not bad enough, it is even more disturbing when you consider that a growing percentage of Americans do not believe that paying taxes is their civic duty.

In 1999, 81 percent of Americans agreed that it's their civic duty to pay taxes. In 2002, only 72 percent agreed with that statement. And last year, that group fell to just 68 percent of the population.

This trend is disturbing. But it is also very clear that more and more people believe that cheating is acceptable. This mind-set undermines our nation's democracy.

While honest Americans are doing their part, a number of others are trying to get by without doing theirs. And that's what this hearing is about.

Some call it the "tax gap" — the difference between the amount of taxes that taxpayers owe the government and the amount of taxes that taxpayers voluntarily and timely pay.

This is not about raising taxes. This is about enforcing the tax laws on the books. This is about collecting the taxes that are owed to the Treasury under the existing tax code.

The Internal Revenue Service's Office of Research estimates the gross tax gap at \$311 billion for tax year 2001. And only about \$55 billion of this will ever be recouped, in part because the IRS does not currently have the resources to ensure that everyone pays what they owe. This leaves a net tax gap of \$255 billion.

These figures are based on the IRS's current estimate of an overall taxpayer noncompliance rate of 15 percent. Playing this out, if we just had a one percentage-point swing in voluntary compliance we could change revenues and reduce the deficit each year by more than \$20 billion.

Moreover, the tax gap exacerbates the long-run imbalance in the Social Security Trust Fund. In 2001, sole proprietors under-reported their income by amounts that reduced Social Security payroll taxes by about \$40 Billion. The Social Security actuary tells us that if we could reduce this tax gap by even 20%, we could reduce the 75-year actuarial imbalance in Social Security by 5.3%.

This would push back the date that the Social Security Trust Fund exhausts by one year. And this would help stave off an increase in payroll taxes or a cut in benefits.

Similarly the Medicare actuary tells us that Medicare's 75-year actuarial imbalance would be reduced by 2.6% and its exhaustion date would be pushed back by one year: from 2019 to 2020.

It is just common sense for us to set a goal — a benchmark of where we should be on tax compliance. In April, I proposed that we shoot for at least a 90 percent tax compliance rate by the end of the decade. That means that by 2010, at least 90 percent of Americans should be filing their taxes and paying their dues. This is not too much to ask.

As we face a Federal deficit of over \$400 billion, the government has to do a better job of collecting the taxes owed. We need a plan of action to close the tax gap.

I am concerned that the IRS does not have the resources it needs to enforce the tax laws. The IRS's fiscal year 2005 budget request does not account for mandatory pay raises, unbudgeted mandatory expenses -- such as rent increases and postage -- and the inability of the IRS to achieve its projected savings from internal productivity growth.

And just last week, the House Appropriations Subcommittee on Transportation and Treasury, and Independent Agencies reduced the Administration's budget request for the IRS by \$382 million.

I am concerned that the IRS will not have adequate funding to increase enforcement initiatives and maintain its taxpayer service at the same time. At some point, the IRS can no longer do more with less. I believe we have reached that point.

But it is not just about more resources. We need to ensure that the IRS modernizes its computer systems and improves its research so that it operates smarter and more efficiently.

We also must pass the tax shelter, Enron-related, corporate governance, and simplification legislation that the Senate has passed several times.

There is no silver bullet to closing the tax gap. Nonetheless, increasing IRS resources, ensuring a smarter and more efficient IRS, and enacting specific legislation will go a long way to closing the tax gap. We have to start somewhere. And we have to start now. Enough talk. I want some action. I look forward to hearing from our witnesses on the schemes used to avoid paying taxes, the nature and size of the tax gap and on recommendations to close the tax gap.

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